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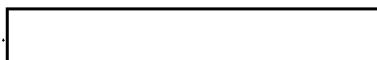
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26 February 1974

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MEMORANDUM FOR:



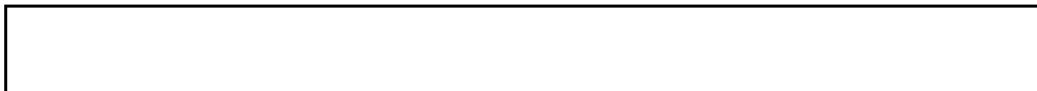
SUBJECT

: OER Contribution to Long-Range DDI
Study on China

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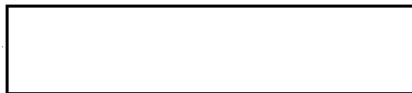
Attached is the economic contribution to the long-range China study. If you have any questions, please phone 

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Chief, China Division

Attachment:
As Stated



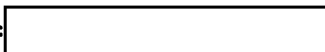
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OER CONTRIBUTION TO LONG-RANGE
DDI STUDY ON CHINACHINA: THE ECONOMY 10 AND 25 YEARS FROM NOWKey Judgments

Ten years from now, in 1984, China will have further out-distanced the other large LDCs such as India, Pakistan, and Indonesia. Yet the PRC probably will not have gained ground on the modern high-technology economies such as Japan, Western Europe, and the United States. China will still be a big poor nation with the potential and ambition for -- but not the realization of -- superpower status.

Rate of Growth

China's GNP will have grown at an average of 4% to 5%, sufficient to support continued expansion of industrial capacity and output, the maintenance of the population at slowly rising levels of well-being, and the equipping of the armed forces with a growing quantity and variety of strategic offensive weapons.

Impact of Political Upheavals on Growth

We anticipate that periods of political turbulence will have had smaller impact than previously because of the in-

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creasing rootedness of Communist economic organizations, controls, and practices. The continued growth of vested interests and the expansion of the corps of technical experts over the next 10 years will have made the economy resistant to all but the most violent political shocks. If this is so, the events that will have accompanied the replacement of Mao and Chou will not have greatly altered fundamental economic patterns in the PRC.

Population

The pressure of population against the means of subsistence will have been relieved slightly by the growth of national output. The impact of China's population control program on total population is likely to have proved negligible. Nonetheless, the program will finally have accumulated sufficient force to permit appreciable cuts in growth rates beyond 1984.

Agriculture

Decreasing returns in the agricultural sector will have been staved off through the completion of major irrigation projects and huge increases in the production of chemical fertilizers. Output of the agricultural sector will have advanced at an average of 2%-3% annually.

Industry

Industrial capacity and output will have doubled compared to 1974. Technology in the metallurgy, electronics, machine-building, and military branches will have made conspicuous advances.

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Efforts to modernize the coal and electric power industries will have been only partially successful. Output of petroleum will have expanded rapidly from a small base. Petroleum exports, while a key factor in China's balance of trade, will constitute only a tiny percent of international supplies.

Foreign Trade

China's foreign trade in 1984 will continue to be overwhelmingly oriented to non-Communist countries, as in 1974. Even though the leadership will be reiterating its policy of economic self-reliance, China almost certainly will have a wider variety of dependence on the major industrial nations -- for modern equipment, new technology, and credits.

Economic Incentives

By 1984, the top leadership will be facing rising discontent among an increasingly literate and technically sophisticated population. Grievances will include austere living conditions and stringent controls over personal life and thought. An especially touchy point will be the manner in which young educated people are assigned to the various urban and rural posts in the economy.

And by the End of the Century?

The possibilities fan out with increasing rapidity between 1984 and the end of the century. Twenty-five years from

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now the Chinese economy could be anywhere between: (a) a state of collapse from overpopulation and/or debilitating military adventures; or (b) a state of world leadership, with China having made uninterrupted progress and the other major nations having failed to cope with shortages of key resources. We believe that the Chinese will land up in between, (a) not hitting the bottom of the range, because the economy has developed a great deal of ballast and the people are tough and flexible, and (b) not reaching the top, because unfavorable labor/land and labor/capital ratios will prevent a spectacular acceleration in economic growth.

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Discussion

Background

1. The economist has great advantages over the political scientist and military expert in foretelling the state of the Chinese or any other society 10 or 25 years from now. Political and military factors are evanescent. Political campaigns or political scandals can erupt overnight. Key leaders can die unexpectedly or suddenly drop from sight. Military alliances are quickly fashioned and quickly dissolved. Military forces are rapidly deployed to new fronts. New weapons change the balance of power in unpredictable ways.

2. In contrast, the economist deals with elements that have tremendous stability over time -- the transportation network, the mills and mines, the farms and irrigation systems, the natural resources, the population pyramid, and the organization and practices of economic life.* The present discussion sets forth the policies and trends in the various sectors of the Chinese economy that are expected to color events over the next decade, 1974-84, and to determine the state of the economy in 1984. An observer coming back to an economy a decade later will almost always find a recognizable assembly

*For a detailed discussion of these enduring elements in the Chinese economy, see the two compendiums sponsored by the Joint Economic Committee of the Congress: (a) An Economic Profile of Mainland China (Washington, Government Printing Office, 1967); and (b) People's Republic of China: An Economic Assessment (Washington, Government Printing Office, 1972).

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of physical facilities and a familiar pattern of organizational practices. On the other hand, a Rip van Winkle of 25 years absence would find numerous fundamental (and unpredictable) changes to absorb in his thinking. Therefore, the portion of the discussion that takes the argument 25 years into the future is necessarily more speculative, less specific and much shorter.

Economic Planning and Administration

3. The year 1974 is the fourth year of the Fourth Five-Year Plan (1971-75), which marked the resumption of regular Soviet-style economic planning after the purges of the Cultural Revolution. The economic planning and administrative system -- with its sub-systems for balancing supplies of materials, procuring and distributing grain, selecting among investment proposals, arranging for inter-organizational transfers of funds, assigning young graduates to their proper slots, and collecting statistics -- presumably will continue to operate through a series of five-year plans. If so, in 1984 the economy will be in the fourth year of a sixth five-year plan, with the organizations, controls, and practices of the Chinese "command economy" more deeply rooted than ever.

4. As the output of a centrally managed economy increases and as technology becomes more complex, the problems of reconciling requirements for men, machines, and materials expand exponentially. China will need a growing corps of economic planners, statisticians, technical specialists, and bureau chiefs to handle a soaring volume of economic

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administrative work. The expansion of this "technostructure" over the next ten years will have important effects on the continuing "red versus expert" problem. The intensified technical training and the enhanced position of the expert in a modernizing China means the creation of new vested interests and a natural tendency toward depoliticization of the expert. Even though the "reds" launch new rectification campaigns in the next decade, their power to discomfit the experts and to interrupt production is waning/-- at least over the long term this is the judgment that underlies the present discussion.

Economic Policy

5. Key decisions made on economic policy in 1972-73 will greatly influence the thrust of economic activity over most of the next ten years. These policies, in general, support the agricultural sector and strengthen the ability of the economy to guarantee minimum subsistence to the growing population.

- Imports of grain were raised to 7.5 million tons in 1973 (in contrast to a normal 5 million tons), and contracts already signed indicate minimum imports of 9 million tons for 1974. Long-term contracts with Canada, Australia, and Argentina extend through 1976;
- Peking in 1973 contracted for \$1.2 billion in Western industrial plants -- mainly chemical fertilizer plants

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and artificial fiber plants -- as compared with only \$60 million in 1972. These new plants, which will come into operation in the late 1970s, will increase China's urea capacity to 5 times the present level and will reduce the pressure on agriculture for natural fibers.

- In spite of China's long-standing reluctance to incur foreign debt, two-thirds of the value of the new plants ordered in 1973 will be financed through deferred payments. The economy will readily handle the level of debt service payments required.

6. The momentum imparted by the grain and industrial contracts, the new credit arrangements, and the general opening of China to wider commercial and scientific contracts will not easily be reversed over the next decade. These economic policy developments reinforce the argument above, namely, that only a major political upheaval will reverse the general direction of economic events in the next decade.

7. In the first two months of 1974, new political ferment has gripped China. Campaigns are underway to insure that the relaxation of revolutionary conduct of the post-Cultural Revolution years does not go too far. We expect that the new political turbulence will not to be pushed to the point where no new contracts will be signed for foreign industrial plants. At a minimum, however, the current political tur-

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bulence serves as a warning to China-watchers against facile straight-line projections of economic policy and growth prospects.

Population Pressure and Population Policy

8. Because of the return to peace, the reduction in infant mortality, and a general improvement in nutrition and public health, population under the Communist regime has grown at 2% annually, compared with 1% or less in the pre-Communist period. The present population control campaign, which began as the Cultural Revolution faded, includes these features:

- official encouragement of later marriage, for example, men at 30 instead of 25, women at 25 instead of 20;
- provision of training in birth control methods and manufacture and distribution of birth control devices and pills;
- use of "barefoot doctors" (youthful rural medical corpsmen) and practical nurses to spread birth control information throughout the countryside;
- widespread propaganda on (a) the need for smaller families as a means of maximizing the participation of women in the labor force, and (b) the error in emphasizing male children as continuers of the family line;
- inclusion of birth control targets in the various economic plans; and
- introduction, on a small scale so far, of specific baby quotas for low-level economic units.

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9. Population for most of the next ten years is likely to continue to increase at 2% because (a) improvements in public health will continue to reduce mortality rates, and (b) the birth control campaign will have little effect beyond city limits, certainly in the first few years. Most observers who have hazarded an estimate of China's population accept the Chinese census figure of 583 million of mid-1953 but part company on the rate of growth. Certainly the authorities in Peking do not know how fast the population has grown since the census. Consider this statement by Vice Premier Li Hsien-nien, Chou's deputy for economic affairs, in an interview with an Egyptian journalist in 1971:

. . . We have been racing against time to cope with the enormous increase in population. Some people estimate the population at 800 million and some at 750 million. Unfortunately, there are no accurate statistics in this connection. Nevertheless, the officials at the supply and grain department are saying confidently, "The number is 800 million people." Officials outside the grain department say the population is "750 million only" while the Ministry of Commerce affirms that "the number is 830 million." However, the planning department insists that the number is "less than 750 million." The Ministry of Commerce insists on the bigger number in order to be able to provide goods in large quantities. The planning men reduce the figure in order to strike a balance in the plans of the various state departments.

10. In this present discussion the population figure accepted for mid-year 1974 is 920 million, which implies an average annual rate of growth of 2.2% -- below the rates in other populous Asian countries with considerably lower standards of public health. If this 1974 figure is used and

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if growth averages 2% over the next 10 years, China's population would number 1,120 million in 1984. If the population control program succeeds in breaking growth down to 1% by the end of the 10 years, with growth for the period averaging 1.5%, the population would reach 1,070 million in 1984. Because of the economic policy changes sketched out above, the extra 130 to 200 million people can be supported. Nonetheless, the people added to the population -- who will contribute practically nothing to over-all output -- represent the continuation of the pressure of an immense and expanding population on overloaded agricultural resources.

Agriculture: Diminishing Returns?

11. After the three disaster years of 1959-61, during which China barely avoided mass starvation and even the toppling of the government, the regime made an about-face in agricultural policy. Previously, planning had focused on the rapid development of heavy and military industry. The agricultural sector had been left to its own resources; increased production was to come from the collectivization of the countryside and from investment based on rural manpower and local materials. Beginning in 1962, the new agricultural policy called for large and steadily expanding inputs into the agricultural sector from the industrial sector -- chemical fertilizer, pumps and other irrigation equipment, tractors, pesticides, and improved varieties of seeds.

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12. During the Cultural Revolution (1966-69), emphasis was redirected to the building of numerous local fertilizer, cement, and agricultural equipment plants. In the last two years, the tide has switched back to the larger modern plants, as witness the huge commitment made in 1973 for the purchase of foreign chemical fertilizer plants. These plants will have their impact starting in the late 1970s. They will give China a capacity for producing urea 6 times as large as capacity at yearend 1973.

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13. The policy of the last decade of insuring the agricultural base of the economy was centered on increasing the yields on the 20% of the tillable acreage with the highest potential for growth. As the volume of inputs to agriculture has climbed, the possibility has risen of diminishing returns; China may soon get a smaller and smaller response of production as larger inputs are applied to less favored acreage. We believe that the spectre of diminishing return will be held off for the next 10 years at least.

Many large rivers still remain to be harnessed; existing improvements in agricultural technology can be spread advantageously to sizable backwater areas; and China is only beginning to exploit the advanced techniques of the "green revolution."

Industry: Advantages of Backwardness

14. At the beginning of 1974, China even while making noteworthy achievements in industry, remains 5 to 20 years or more behind in the various industrial branches.

- Whereas the Chinese manufacture basic transportation and steel-making equipment, they must turn to Western Europe and Japan for advanced vehicles and steel furnaces and rolling mills.
- Whereas China has just announced the successful trial production of its initial third generation computer, the United States and Japan have been moving rapidly beyond the third generation of computers.

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- Whereas the Chinese are capable of manufacturing the equipment for exploration and drilling for onshore oil, they must turn to the United States and other suppliers for offshore equipment;
- Whereas the Chinese are in the process of deploying several dozen missiles of medium and intermediate range, the United States and the USSR have for some time deployed hundreds of intercontinental missiles, some of incredible complexity and accuracy.

15. Over the next 10 years, Chinese industrial production probably will increase at an average annual rate of about 8%. By 1984, then, industrial production will be twice the present level and will have benefitted from major infusions of both domestic and foreign technology.

16. The PRC has ample opportunities remaining of obtaining low-cost technology embodied in foreign plant and equipment. The major industrial nations, which will have to cough up billions more to pay for their oil, will be anxiously contending for their share of the Chinese market. Even though China's purchases remain small by world standards, they are growing rapidly and will be boosted over the next 10 years by Peking's less puritanical attitude toward credit. At the same time that China will be making great technological strides, the high-technology nations will be driving ahead on the R&D frontier. China will continue to benefit from its

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relative industrial backwardness, that is, in 1984 it will still be able to obtain plant and equipment on which R&D costs have been paid off and technical problems ironed out.

17. Petroleum production by 1984 will have expanded to several times the current level of 1 million b/d. Most of the additional output will have come from the exploitation of large new onshore fields opened in the early 1970s. Limitations on the expansion of production in these fields does not arise from lack of resources or technical competence but from limitations on production equipment and pipelines. In the contrasting case of offshore fields -- which almost certainly will become an appreciable part of China's output in the 1980s -- the acquisition of foreign technology will be a critical factor in determining the pace of development.

18. While petroleum plays the glamour role, coal will continue to supply the great bulk of China's primary energy even in 1984. Recent increases in the production of coal have been realized only because of intensified working of existing mines, sometimes to the point of rapidly diminishing returns. The failure to invest in large new mines during the current plan period is attributable not to oversight but rather to the higher priority needs of agriculture and its supporting industries. This failure will be reflected over the next 10 years in tight supplies of coal and electric power.

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19. In 1984, military production will have moved forward in the quantity and variety of weapons for all branches of the armed forces, with the most prominent gains having been made in the production of strategic offensive weapons.

Foreign Trade: Tied to the West

20. The policy changes of 1972-73, which entail larger imports of grain and industrial plants and recourse to foreign credit, do not mean an abandonment of China's key economic goal of self-sufficiency. Peking has correctly concluded that imports of equipment and know-how from Japan, Western Europe, and the United States give China its only chance for ultimate self-sufficiency in production of ^{grain,} modern machinery and weapons. Over the next ten years, the plant and equipment now being ordered will give China's modernization program a fillip, especially in chemical fertilizer, artificial fibers, iron and steel, electronics, and transportation.

21. By 1984, the volume of China's foreign trade in real terms will have roughly doubled. The pattern of trade will have the following features, which in most cases are holdovers from 1974.

- China will gain low-cost food and industrial equipment, materials, and technology in return for raw materials, light manufactures, and high-value foodstuffs;
- Roughly 80% of trade will continue to be with the non-Communist countries; Peking will deliberately

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spread its orders for industrial plant among a number of suppliers -- Japan, the United States, West Germany, France, the UK, Italy, and the smaller nations of Western Europe;

- The tremendous imbalance of trade to be expected with these suppliers will continue to be offset by the more than one billion dollars net earnings in dealings with Hong Kong; this pattern, of course, will be operative in 1984 only if Peking's relations with the Crown Colony have continued on the same track;
- China's imports of grain, which have recently been rising toward 10 million tons a year, will have fallen back to a trickle in 1984 if the expansion of the chemical fertilizer industry has worked out as planned; the United States probably will have become a ^{minor} supplier of grain, being turned ^{only} to/when Canada, Australia, and Argentina are unable to fill China's orders, and
- Petroleum will have become a key export for China, even though the amount involved will be peanuts by international standards.

Living Standards: Up Enough?

22. From 1949 to 1974 -- with the exception of the disaster years of 1959-61 -- the Chinese Communist regime has been able to supply a growing population with the basic necessities

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of life. Small yet palpable increases in living standards have gradually been achieved:

- Thanks largely to the private garden plots and livestock holdings, the quality, variety, and availability of foods have been improving;
- Cautious advances have been made in the color and variety of wearing apparel;
- Steady gains have been made in the replacing or upgrading where notable improvement has come from after-hours work and local building materials;
- Sizable percentage gains have been made in the production and sale of basic consumer durables -- wrist-watches, transistor radios, bicycles, sewing machines, and kitchenware; and
- Increases in collective consumer services -- transportation, education, health, and entertainment -- have added to the actuality and the feeling of well-being in the PRC.

23. The distribution of income in China is highly egalitarian by the standards of Asia. Nevertheless, a considerable amount of inequality is permitted, mainly as a means of spurring productivity. The problem is whether enough resources are available to keep up productive morale. The Peking leadership faces the "What have you done for me lately?" syndrome. The great majority of the population has no clear

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remembrance of how bad things were before 1949. As the Cultural Revolution advocates claimed, revolutionary fervor is lacking on the part of the young and those older people with accumulated vested interests. Furthermore, a built-in conflict exists between the widening of literary and technical sophistication and the maintenance of austere standards of consumption. Traditionally, the Chinese people have kept private their thoughts and way of life. By no means are they completely won over to the Maoist way of public "struggle, criticism, transformation." By 1984, living standards should have risen perceptibly above the standards of 1974. The government almost certainly will have proved able to contain any discontent with the slowness of advance and with the contrast between spartan consumption and rapid technical advances.

Experts Have Post Position

24. The ten years between 1974 and 1984 will have seen a further proliferation and professionalization of the economic and engineering bureaucracy (the "technostructure"). In the "red versus expert" confrontation, the future will belong to the expert in spite of Chairman Mao's efforts.

Twenty-five Years into the Future

25. Whereas the economic prognostications for 1984 are based on considerable foreknowledge of the state of China's capital plant, the possibilities widen rapidly when we push out farther into the future. Among the major factors affecting the future:

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- The population growth rate, which will be fairly stable for 10 years, could change by a percentage point or more over 25 years, with substantial effect on Peking's ability to support industrial and military expansion;
 - China's self-sufficiency in energy could be a telling advantage by the turn of the century or could mean little in the event the presently beleaguered industrial nations have solved their energy problems;
 - The struggle between the "red" and "expert" political philosophies in China could lead to marked changes, up or down, in the rate at which China accumulates capital plant and technology over 25 years;
 - The foreign trade pattern, which now has a general pattern locked in for some years by contracts with non-Communist countries for grain and industrial equipment, may alter in wholly unforeseen ways as China moves beyond the 1970s; and
 - Political and military developments of the next several years could bend the economy toward new goals that would have a pronounced effect by the turn of the century on many of the fundamental characteristics of the economy described previously.
26. If everything went wrong economically and/or China suffered a military defeat or other disaster, the economy

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could be in a state of collapse by the year 2000. To examine the economic side only, this worst possible case is unlikely because of (a) the high quality of China's population as the human raw material for economic development, (b) the strong chances of success in population control toward the end of the century, (c) the tremendous natural resources, which easily meet superpower standards, and (d) the growing amount of "economic ballast", that is, the stabilizing effect of the growing accumulation of physical, technological, and organization capital.

27. Nor is the best possible case -- which combines relief from the Malthusian trap, smooth absorption of foreign technology, avoidance of political turbulence, and the inability of rival nations to adjust to energy shortages -- a likely case. Too much of the governing philosophy in the PRC stems from the Long March and the Yen'an period and will constitute a barrier to extraordinarily rapid development. Furthermore, the tensions within China as to which people get the small number of slots in the educational system and which young graduates get the cushy urban posts will hardly disappear in the next 25 years.

28. Thus, within the huge range of possible outcomes after 25 years, we believe the actual outcome will be within a still wide range of middle possibilities. China almost

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certainly will not be a superpower in the class of the US or the USSR (or a possibly united Europe or a possibly re-energized Japan). Within this middle range of hypothetical outcomes, the PRC could be either (a) well on its way to superpower status, or (b) remaining far behind the high-technology countries as a big and still poor nation.